Supreme Court, U.S.
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No. 97-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1996

ASTORIA FEDERAL SAVINGS & LOAN ASSOCIATION,
Petitioner,

vs.

THE STATE OF NEW YORK and NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE (JAMES J. WEXLER, COMMISSIONER OF TAXATION AND FINANCE) and THE CITY OF NEW YORK,
Respondents.

PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF NEW YORK,
APPELLATE DIVISION, SECOND DEPARTMENT

PETITION FOR A WRIT OF CERTIORARI

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May 5, 1997

QUESTIONS PRESENTED

1. Whether, by the use of fraudulent preambles or subjective interpretations of a statute, a State can legally impair contractual obligations created by a statute by ignoring established principles of contract law and finding a legislative intent for a covenant to the contract which is contrary to the plain wording of the statute in order to deprive the bondholders of valuable contract rights?

2. Whether the retroactive repeal of a statutory bond covenant violates rights under the Due Process Clause of the Fifth and Fourteenth Amendments of the Constitution of the United States?

LIST OF PARTIES

The Petitioner and Respondents are identified in the caption appearing on the cover and at page one of this statement. The parent corporation and wholly owned subsidiary or affiliated companies of Petitioner, Astoria, are:

Parent Corporation:

Astoria Financial Corporation

Subsidiary Corporations:

AF Staten Island Development Corp.
AF Roosevelt Avenue Corp.
AF Glen Cove Corp.
AF Cortlandt Corp.
AF Agency Corp.
FNY Service Corp.
3 Belmont Corp.
Fidata Service Corp.
Shoratlantic Development Corp.
SFS Resources Corp.
Shorham Development Corp.

Affiliated Corporations:

Dollar Service Corporation
420 E. 58TH ST. Service Corp.
Elko Apartments, Inc.
Elko Properties, Inc.
Gram Corp.
Bayside Mall Real Property Holding Corp.
14TH ST. Real Property Holding Corp.
Fairfield Connecticut Properties

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vs.

THE STATE OF NEW YORK and NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE (JAMES J. WEXLER, COMMISSIONER OF TAXATION AND FINANCE) and THE CITY OF NEW YORK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF NEW YORK,
APPELLATE DIVISION, SECOND DEPARTMENT

PETITION FOR A WRIT OF CERTIORARI

Petitioner, Astoria Federal Savings & Loan Association, ("Astoria"), respectfully prays that a writ of certiorari issue to review the final judgment of the Supreme Court of the State of New York, Appellate Division, Second Department, dated July 8, 1996.

OPINIONS BELOW

The July 8, 1996 opinion of the Appellate Division of the New York Supreme Court, whose judgment is herein sought to be reviewed, is reported at 222 A.D.2d 36, 644 N.Y.S.2d 926, and is reprinted as Appendix A to this petition. The prior

opinion of the New York Supreme Court, dated August 29, 1994, is not reported but is reprinted as Appendix B to this Petition. The order of the Court of Appeals dismissing the appeal *sua sponte* is reported at 88 N.Y.2d 1064, 651 N.Y.S.2d 407, 674 N.E.2d 337, and is reprinted as Appendix C. The order of the Court of Appeals denying Astoria's motion for leave to appeal is reported at 89 N.Y.2d 807 and is reprinted as Appendix D. Neither order of The Court of Appeals was accompanied by an opinion.

JURISDICTION

By an order entered October 22, 1996, the Court of Appeals of the State of New York dismissed, *sua sponte*, for lack of a substantial constitutional question, a timely appeal from the Appellate Division judgment. Astoria then timely moved for leave to appeal, which was denied by the Court of Appeals, in an order entered February 6, 1997. This appeal is being docketed in this Court within 90 days from February 6, 1997, the date of entry of the order of the Court of Appeals denying Astoria's motion for leave to appeal. The jurisdiction of this Court is invoked under 28 U.S.C. §1257(2)

The fact that the New York State Court of Appeals denied Astoria's request for appeal, finding there were no substantial constitutional issues involved herein, does not preclude this Court from making its own determination of the constitutional questions. "It is settled that [whether] a pleading sets up a sufficient right of action or defense, grounded on the Constitution or a law of the United States, is necessarily a question of federal law; and where a case coming from a state court presents that question, this Court must determine for itself the sufficiency of the allegations displaying the right or defense, and is not concluded by the view taken of them by the state court. *First National Bank v. Anderson*, 269 U.S. 341, 346; *Staub v. City of Baxley*, 355 U.S. 313, 318." *Allied Stores of Ohio, Inc. v. Bowers, Tax Commissioner of Ohio*, 358 U.S. 522, 525 (1958). Thus this Court has jurisdiction in this matter.

CONSTITUTIONAL PROVISIONS AND STATUTES

Constitution of the United States:
Article I, Section 10, Clause 1

No state shall enter into any treaty, alliance, or confederation; grant letters of marque and reprisal; coin money; emit bills of credit; make anything but gold and silver coin a tender in payment of debts; pass any bill of attainder, ex post facto law, or law impairing the obligation of contracts, or grant any title of nobility.

Amendment 5

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Amendment 14

All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

United States Code

31 U.S.C. § 3124. Exemption from taxation

(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that

would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except --

(1) a nondiscriminatory franchise tax or another non-property tax instead of a franchise tax, imposed on a corporation; and

(2) an estate or inheritance tax.

New York Statutes

Public Authorities Law § 1045-t
Public Authorities Law § 1045-u
Public Authorities Law § 1045-bb

Section 22 of Chapter 166 of the Laws of 1991

The foregoing provisions of the New York State Public Authorities Law are reprinted as Appendix E. Section 22 of Chapter 166 of the Laws of 1991 is reprinted as Appendix G.

STATEMENT OF THE CASE

The petitioner is a Federal savings and loan association chartered under the laws of the United States, with its principal office for the conduct of business located at One Astoria Federal Plaza, Lake Success, New York 11042. As such it is subject to the New York State and City franchise taxes for the privilege of doing business.

In 1984, the New York State Legislature created the New York City Municipal Water Finance Authority. Between 1984 and 1990 eleven similar public local water authorities were created by successive legislatures. Each of the acts creating the twelve public water authorities followed the same Model Act and contained virtually all of the same provisions. The petitioner purchased and still owns bonds issued by the New York City Municipal Water Finance Authority (the "Authority").

As originally enacted in 1984 and at the time of petitioner's purchase of the bonds, Public Authorities Law § 1045-u.3 pertaining to the New York City Municipal Water Finance

Authority (referred to hereinafter as the "Exemption Provision") read, in pertinent part, as follows:

> Any bonds issued pursuant to this title together with the income therefrom as well as the revenues, moneys and all other property and activities of an authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. The State hereby covenants with the purchasers and all subsequent holders and transferees of bonds issued by an authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom and all revenues, moneys, and other property pledged to secure the payment of such shall at all times be free from such taxes, except for transfer and estate taxes.

A further provision, Public Authorities Law §1045-t, entitled, Agreement with the state, provides:

> "The state does hereby pledge to and agree with the holders of any bonds issued by the authority pursuant to this title that the state will not alter or limit the rights hereby vested in the authority or the water board to fulfill the terms of any agreement made with or for the benefit of the holders of bonds, or in any way impair the rights and remedies of bondholders, until the bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of such holders, are fully met and discharged. The authority is authorized to include this pledge and agreement with bondholders."

(Similar language appears in the Model Act, Public Authorities Law § 1196-1 of Title 8-A, and in various other sections

of the Public Authorities Law, creating uniformity as to all revenue bonds issued by the twelve local water and sewer public authorities.)

Public Authorities Law § 1045-bb specifically provides that the provisions of Title 2-A, pertaining to the Municipal Water Finance Authority, shall be controlling when there is a conflict with the provisions of any other law, general, special or local.

On or about December 18, 1990, the Department of Taxation and Finance issued Memorandum TSB-M-90(14)C, (reprinted as Appendix F) which stated that the exemption from franchise tax contained in the Model Act and the acts creating the individual public water authorities related to the public water authority and not to the bonds or the interest therefrom and thus such bonds and the interest were subject to franchise tax.[1]

On June 3, 1991, amendments to the Public Authorities Laws were introduced to the Legislature to revoke the exemption from franchise taxes. These amendments, described as "clarifying" in its preamble, which is reprinted as Appendix G, were introduced pursuant to the Governor's Message of Necessity, together with numerous amendments of various other statutes, which Message under the New York State Constitution, must be voted upon immediately, in its entirety, by the legislature without discussion or floor debate. The bill became law (Chapter 166) on June 12, 1991. The amendments to the Public Authorities Law were declared to be

---

[1] In issuing said Memorandum, the Department was aware that if the bonds and interest thereon was exempt from the franchise tax, the obligations of the United States and the interest thereon would also be exempt from the State franchise tax. Under 31 U.S.C. § 3124, a state must exempt Federal obligations and the interest thereon from a franchise tax such as the New York State and City franchise taxes if any of the State's obligations are exempt. (See *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, *Werner Mach. Co. v. Director of Div. of Taxation*, 350 U.S. 492, *Commonwealth v. Curtis Pub. Co.*, 69 A2d 410, 363 Pa. 299, cert denied 339 U.S. 928)

effective retroactive to July 24, 1984, the original effective date of the Model Act (§ 406(d)(1) of Chapter 166). Identical retroactive amendments were made to the local water and sewer authority acts contained in the Public Authorities Law. (§§ 22, 25-36; § 406(d) of Chapter 166, Laws of 1991)

Judicial Proceedings

Petitioner commenced a declaratory judgment action in the Supreme Court of the State of New York, County of Nassau, seeking a determination of the constitutionality of the 1991 amendment (which was made retroactive to 1984) to Public Authorities Law § 1045-u.3, which relates to the exemption from taxes for bonds, as well as the interest thereon, issued by the New York City Municipal Water Finance Authority. The City of New York (hereinafter, the "City Respondent") moved to intervene in the case as a party-defendant, which motion was granted without opposition.

Petitioner contended that the amendment is unconstitutional because it impairs petitioner's contract rights in violation of Article I, § 10, Clause 1 of the United States Constitution, as well as violating petitioner's rights to due process under the Fifth and Fourteenth Amendments to the United States Constitution.

The Order and Opinion of the Hon. Marvin E. Segal, J.S.C., New York Supreme Court, Nassau County, dated August 29, 1994, and entered September 2, 1994, (reprinted as Appendix B) denied petitioner's motion for summary judgment and granted the cross-motions of the State Respondents and City Respondent for summary judgment. The opinion found that the Exemption Provision as enacted in 1984 was unclear and ambiguous due to "inartful draftmenship" and in the absence of clear and convincing evidence otherwise, the court could not depart from an administrative construction of a statute since the reference in the statute to franchise taxes could rationally be construed as being relevant only to the authority. No reference was made in the opinion to the specific covenant that the State made to the bondholders that the bonds of the authority and the income therefrom

would be free from franchise taxes nor to the applicability of the Contract Clause.

The Opinion and Order of the Appellate Division, Second Department, entered July 8, 1996 (reprinted as Appendix A) affirmed the New York Supreme Court Order The Appellate Division held that the bonds issued by the public water authority and the interest thereon were not exempt from franchise tax pursuant to Public Authorities Law §§ 1045-u.3 and 1196-l.3, as enacted in 1984, but if such bonds and the interest thereon were exempt from franchise tax under the law as originally enacted, the retroactive amendment thereof in 1991, repealing the exemption was not violative of the plaintiff-petitioner's "due process" rights under the Constitutions of the United States and the State of New York since such repeal was not "harsh or oppressive". In affirming the decision of the lower court, the Appellate Division found that, "In addition, by its *plain language* [the statute] exempts bonds and the interest on bonds from 'franchise taxes'." [Emphasis supplied] Despite this, the court resorted to its subjective application of the rules of statutory construction and held that the legislature could not have intended to enact a covenant exempting the bonds and interest thereon from the franchise tax particularly in view of the effect that such exemption would have on the taxation of obligations of the United States and the interest thereon. Again, no reference was made in the opinion to the specific covenant that the State made to the bondholders that the bonds of the authority and the income therefrom would be free from franchise taxes nor to the applicability of the Contract Clause.

On August 5, 1996, Petitioner filed and served a Notice of Appeal to the Court of Appeals pursuant to CPLR § 5601(b)(1). By Order entered October 22, 1996, that Court, *sua sponte*, dismissed the Petitioner's appeal on the ground that no substantial constitutional question is directly involved. Said Order, reprinted as Appendix C, with Notice of Entry was served on Petitioner on October 29, 1996.

By Notice dated November 22, 1996, petitioner timely sought leave to appeal to the Court of Appeals. By Order dated and entered February 6, 1997 (reprinted as Appendix D), petitioner's motion for leave to appeal was denied.

REASONS FOR GRANTING THE WRIT

Petitioner seeks to invalidate, on constitutional grounds, a retroactive amendment to the Public Authorities Law that revoked a covenant from the State to the holders of bonds issued by a public authority declaring that the bonds and the interest thereon would remain exempt from the measure of a corporation's New York State and City franchise taxes. The matter involves issues of federal constitutional law with broad federal implications. At issue is the State's attempt to renege on promises made to corporate bondholders in legislative enactments made over a five year period on the perceived presumption that the legislators did not know or mean what they said. Further, the decisions of the courts below ignored the covenants made to the bond holders and are contrary to the prior decisions of this Court. The only time this century that this Court has permitted the alteration of a municipal bond contract was in *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), which involved the bonds of a bankrupt local government. In addition, the issues involved herein are significant as there are numerous other banks and other corporations which have pending actions with the State and City of New York on the very same issue.

I.

Whether, by the use of fraudulent preambles or subjective interpretations of a statute, a State can legally impair contractual obligations created by a statute by ignoring established principles of contract law and finding a legislative intent for a covenant to the contract which is contrary to the plain wording of the statute in order to deprive the bondholders of valuable contract rights?

A. Bonds issued by a State, or agency thereof and the covenants thereto are contracts.

It is amply clear that bonds issued by states and the covenants thereto are contracts. "In general, a statute is itself treated as a contract when the language and circumstances evince a legislative intent to create private rights of a contractual nature enforceable against the State." *United States Trust Company of New York v. New Jersey,* 431 U.S. 1, 17 n14, 97 S.Ct. 1505 (1977) In that case the Court found that the State's obligation was itself created by a statute, and the "intent to make a contract is clear from the statutory language." (Id at 18) Similarly, in the instant case the obligation and covenant were created by a statute which clearly manifested the intention to make a contract with the bondholders.

B. As contracts, the covenant involved herein is subject to the principles of Contract Law.

In the instant case the bond covenant is in writing and clearly states that the bonds and interest thereon are exempt from franchise tax. There is no ambiguity in the language of the covenant to permit the use of extrinsic evidence or subjective interpretation of the presumed intent of the legislature. Any ambiguity was created by the abuse of the principles statutory construction to find that the legislature could not have intended to grant such exemption. Patently this is a violation of the parol evidence rule of contract law which provides that extrinsic evidence can not be used to vary or contradict the terms of an unambiguous and integrated

contract that is a writing that the parties have adopted as the expression of their final agreement (29 Am. Jur.2d § 1092).

While there does not seem to be any decisions precisely on point as to whether the parol evidence rule applies to contracts created by a State statute, this Court has denied the admission of "parol proof" to show extrinsic evidence. *Miles v. Caldwell*, 69 U.S. 35, 39, 2 Wall. 35 (1864) Moreover there have been numerous statements by this Court that contracts of States for the borrowing of money are the same as contracts made by ordinary citizens. Contracts made by ordinary persons are subject to the parol evidence rule and thus the rule would apply to the contracts of a State. "The truth is, States and Cities, when they borrow money, and contract to pay it with interest are not acting as sovereignties. They come down to the level of ordinary individuals. Their contracts have the same meaning as that of similar contracts between private persons." *Murray v. Charleston,* 96 U.S. 432, 445 (1877). See also, *United Trust Company of New York, supra*, 25 n23.

C. The impairment of the debt was unreasonable.

The State's action in retroactively repealing the covenant was not made to exercise the sovereign right of the Government to protect the lives, health, morals, comfort and general welfare of the people. Such repeal was made to avoid the financial consequences. See *Home Building & Loan Association v. Blaisdell,* 290 U.S. 398, 439, 54 S.Ct. 231 (1934) wherein it was stated,

> "Undoubtedly, whatever is reserved of state power must be consistent with the fair intent of the constitutional limitation of that power. The reserved power cannot be construed so as to destroy the limitation, nor is the limitation to be construed to destroy the reserved power in its essential aspects. They must be construed in harmony with each other. This principle precludes a construction which would permit the State to adopt as its policy the repudiation of its debts or the destruction of contracts or the denial of means to enforce them." See also,

City of El Paso v. Simmons, 379 U.S. 497, 85 S.Ct. 577 (1965)

"If a State could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *U.S. Trust Company, supra,* at 26. "Legislation adjusting the rights and responsibilities of the contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption." Id at 22

D. This Court is not limited to merely considering the opinion of the lower court in determining whether there has been an impairment of contract by later legislation.

> "It is equally well settled that, where the state court does give effect to later legislation which operates to impair the obligation of a contract if one exists, this court is not deprived of jurisdiction because the state court has put its decision upon the ground the contract was not made, or that it was invalid, or that it has become inoperative. In such a case, this court must determine for itself whether there is an existing contract. Otherwise, although it was the aim of the suit and the effect of the judgment to give vitality and operation to the subsequent law, and this court might be of the opinion that there was a valid contract which thereby would be impaired, it would be powerless to enforce the constitutional guarantee. *** And, in determining whether effect has been given to the later statute, this court is not limited to the mere consideration of the language of the opinion of the state court." *Louisiana Railway & Navigation Company v. Behrman,* 235 U.S. 164,170-171, 35 S.Ct. 62 (1914). See also *Columbia Railway, Gas & Electric Company v. State of South Carolina,* 261 U.S. 236, 43 S.Ct. 306 (1923)

II.

The retroactive repeal of the tax exemption covenant also violates Petitioner's right under the Due Process Clause of the Fifth and Fourteenth Amendments of the Constitution of the United States.

In abrogating Astoria's contract rights under the tax exemption covenant the State seized valuable property rights without the payment of any consideration. Contract rights are a form of property. *Contributors to Pennsylvania Hospital v. Philadelphia,* 245 U.S. 20, 38 S.Ct. 35 (1917).

The State could have used its power of eminent domain to acquire the covenant exempting the bonds and the interest thereon from franchise tax without impairing the obligation of contract but then it would had to compensate the bondholders. Instead the State peremptorily retroactively repealed the covenant in contravention of the Contract Clause and abrogated contract rights in violation the Due Process Clauses of the Fifth and Fourteenth Amendments of the United States Constitution.

The State's action was motivated by sheer greed without regard to the constitutionality of its action. The reliance of bondholders was cemented by two expressed promises by the State. These promises could not be clearer or more forceful. Moreover, the bondholders had no warning whatsoever that the exemption, in existence for seven years, would be so abruptly withdrawn by an amendment buried within a massive budget bill that was introduced and passed on the same day. These facts speak volumes about the fundamentally unfair manner in which the 1984 tax exemption was repealed.

Further, the State should not be permitted to use fraudulent preambles, describing a retroactive appeal as merely a clarifying amendment, to circumvent constitutional rights. The Appellate Division erroneously viewed merely the period of retroactivity in deciding that it was not "harsh or oppressive." However by such seizure, Astoria was deprived of its property

rights not only for the period of retroactivity but also for as long in the future as it owns the bonds.

CONCLUSION

For the foregoing reasons, the petitioner respectfully prays that its petition for a writ of certiorari be granted.

Respectfully submitted,

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May 5, 1997

APPENDIX

APPENDIX A

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION : SECOND JUDICIAL DEPARTMENT

Argued - March 4, 1996

_____AD2d_____

ALBERT M. ROSENBLATT, J.P.
JOHN COPERTINO
MYRIAM J. ALTMAN
WILLIAM D. FRIEDMANN, JJ.

94-08656 OPINION & ORDER

Astoria Federal Savings & Loan Association, appellant, v State of New York, et al., respondents, City of New York, intervenor-respondent.

APPEAL by the plaintiff in an action, *inter alia,* for a declaratory judgment, from an order and judgment (one paper) of the Supreme Court (Marvin E. Segal, J.), entered September 2, 1994, in Nassau County, which denied its motion for summary judgment, granted the cross motions of the defendant and intervenor-defendant for summary judgment, and declared that Public Authorities Law § 1045-u(3), as originally enacted, did not exempt bonds issued by the New York City Municipal Water Finance Authority and the interest they generate from inclusion in a corporate bondholder's total net income for the purpose of calculating the corporation's New York City and New York State franchise tax obligations.

Hutton & Solomon, LLP, New York, N.Y. (Stephen L. Solomon, Roy F. Hutton, Kenneth I. Moore, and R.Gordon Abitbol of counsel), for appellant.

Dennis C. Vacco, Attorney-General, New York, N.Y. (Carol E. Fiske and Bernadine M. Koch of counsel), for respondents.

Paul A. Crotty, Corporation Counsel, New York, N.Y. (Edward F.X. Hart and Amy F. Nogid of counsel), for intervenor-respondent.

FRIEDMANN, J.

On this appeal, we are asked to consider whether Public Authorities Law § 1045-u(3), as originally enacted, exempted the bonds issued by the New York City Municipal Water Finance Authority and the interest they generate from inclusion in a corporate bondholder's entire net income for the purpose of calculating the corporation's New York State and New York City franchise tax obligations. Should the section be susceptible of such a construction, we are additionally asked to determine whether the retroactive application of a 1991 amendment to Public Authorities Law § 1045-u(3) violated existing bondholders' contractual or constitutional rights.

In 1984 the New York State Legislature enacted the New York State Local Water and Sewer Authority Act (hereinafter the Act) (*see*, L 1984, ch 510; Public Authorities Law §1196-*a et seq.*). The purpose of the Act was to enable local governments to provide safe and adequate supplies of water and sewerage services to the public, with ease and expedition (*see*, Public Authorities Law § 1196-a). In furtherance of that aim, it authorized local authorities to obtain financing for water and sewer improvements (*see*, Public Authorities Law § 1196-a). Under the Act, the New York State Legislature had the power to create local water and sewerage authorities (*see*, Public Authorities Law § 1196-c[1]). In addition, the legislation set forth, among other things, the general powers of such authorities (*see*, Public Authorities Law § 1196-d) and the tax consequences of their creation (*see*, Public Authorities Law § 1196-1).

Simultaneously with the passage of this Act, the New York State Legislature passed the New York City Municipal Water

Finance Authority Act (*see*, L 1984, ch 513, § 1; Public Authorities Law § 1045-*a et seq*., eff July 24, 1984). The purpose of the latter was to create alternative financing methods for New York City water projects (*see*, L 1984, ch 513, § 1). This legislation created the corporation known as the New York City Municipal Water Finance Authority (*see*, Public Authorities Law §1045-c[1]), and gave that Authority the power to issue bonds in order to obtain capital (*see*, Public Authorities Law § 1045-d[3]). Between 1984 and 1990, the State Legislature passed similar legislation creating 11 additional local water and sewer public authorities, all of which were similarly empowered to issue bonds.

The provision at issue here, Public Authorities Law § 1045-u(3), as enacted in 1984, reads as follows:

> "Any bonds issued pursuant to this title together with the income therefrom as well as the revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees or charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. The state hereby covenants with the purchasers and all subsequent holders and transferees of bonds issued by the authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom and all revenues, moneys, and other property pledged to secure the payment of such shall be at all times free from such taxes, except for transfer and estate taxes" (*see also*, Public Authorities Law §§ 1196-1[3], 1045-k[4]).

On December 18, 1990, the New York State Department of Taxation and Finance issued a memorandum which addressed the question, posed by some corporate bondholders, of whether bonds issued by public authorities (including the

New York City Municipal Water Finance Authority [hereinafter the Authority]), or the interest from those bonds, was "exempt" from New York State corporate franchise taxation under the language of Public Authorities Law § 1045-u(3). The Department concluded that "the term 'franchise taxes'" in, *inter alia*, Public Authorities Law § 1196-1(3) and § 1045-u(3), "refers to and modifies the exemption from taxation of the activities of the Authority but not the bonds or the interest from the bonds of the Authority". Accordingly, the Department concluded, the interest on the bonds should be included in a corporation's computation of its "entire net income"used to determine its franchise taxes. This reading was consistent with the long-standing policy of the New York State Department of Taxation and Finance, which had always required that the interest earned on comparable bonds be considered as income for franchise tax purposes.

In 1991, the New York State Legislature amended Public Authorities Law § 1045-u(3) and related sections (*see*, L 1991, ch 166, §§ 22-36), to read as follows:

> "Any bonds issued pursuant to this title together with the income therefrom shall be exempt from taxation except for transfer and estate taxes. The revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees or charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes. The state hereby covenants with the purchasers and with all subsequent holders and transferees of bonds issued by the authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom shall be free from such taxation, as aforestated herein, and that all revenues, moneys, and other property pledged to secure the payment of such bonds shall at all times be

free from such taxes as aforestated herein" (*see*, L 1991, ch 166, § 26).

The Preamble to the 1991 amendment set forth that its purpose was to make it "unquestionably clear" and to "reaffirm" that the bonds issued by the Authority and the interest from those bonds had always been subject to indirect taxation, including State and local franchise, estate, gift, and transfer taxes (*see*, L 1991, ch 166, § 22). The effective date of the 1991 amendments was retroactive to July 24, 1984 (*see*, L 1991, ch 166, § 406[d]; Effective Date of Amendment, McKinney's Cons Laws of NY, Book 42, Public Authorities Law § 1045-u, at 645).

II

In 1986, the plaintiff, a Federal savings and loan association, purchased Water and Sewer revenue bonds, Series A, issued by the Authority. The bonds, which accrue interest at an annual rate of .25%, are scheduled to mature on June 15, 2015. The offering statement of the bonds declared: "In the opinion of Bond Counsel, under existing law interest on the Series A Bonds is exempt from Federal income taxes and from personal income taxes levied by New York State or any political subdivision thereof, including The City of New York". Over the ensuing several years, the plaintiff included the revenues from these bonds in its computation of income for franchise tax purposes.

On or about February 26, 1993, the plaintiff commenced this action against the State of New York and the New York State Department of Taxation and Finance, seeking a judgment declaring, *inter alia*, that the language of Public Authorities Law § 1045-u(3), as originally enacted in 1984, exempted the bonds issued by the Authority, and the interest they generate, from inclusion in a corporate bondholder's entire net income for the purpose of calculating a corporation's franchise tax obligations. According to the plaintiff's reading of Public Authorities Law § 1045-u(3), as originally enacted, the exemption from franchise taxes accorded to the Authority in the first sentence of the statute was carried over into the

"covenant" with purchasers in the second sentence's promise that all purchasers would similarly be "free from *such* taxes, except for transfer and estate taxes". To the extent that the 1991 amendment altered the latter promise, the plaintiff argued, it violated constitutional guarantees of due process and rights of contract. In an order dated November 18, 1993, the Supreme Court, Nassau County, granted the City of New York's unopposed motion to intervene.

Thereafter, the plaintiff moved for summary judgment and the State and City cross-moved for summary judgment. The Supreme Court denied the plaintiff's motion, granted the State's and the City's cross motions, and declared that Public Authorities Law § 1045-u(3), as originally enacted, did not exempt bonds issued by the Authority and the interest they generate from inclusion in a corporate bondholder's total net income for the purpose of calculating the corporation's New York City and New York State franchise tax obligations.

We now affirm.

III

Franchise taxes are excise taxes imposed on corporate entities for the privilege of carrying on a business as a corporation (*see, e.g.*, Black's Law Dictionary 593 [5th ed 1979]; 71 Am Jur 2d, State and Local Taxation, § 266, at 583-584; 24 NY Jur, Franchises, § 1, at 2-4; 37 CJS, Franchises, § 1, at 141-147; 12 McQuillin, The Law of Municipal Corporations, Franchises § 34.03, at 10-11 [3d ed]). A franchise tax is an indirect rather than a direct tax on a corporation's entire net income (*see, Werner Mach. Co. v Director of Div. of Taxation,* 350 US 492; *Matter of Anchor Sav. Bank v Chu,* 117 AD2d 889). Put somewhat differently, a franchise tax is not levied directly on, for example, bond income or the bonds themselves, even though the amount of the tax is determined by the size of a corporation's total income, including investment income (see, *e.g., Educ. Films Corp. of Am. v Ward, 282 US* 379, 386-392; *Flint v Stone Tracy Co.,* 220 US 107, 165). New York State Tax Law article 9-A imposes a franchise tax on corporations (Tax law § 209); and article 32-A

expressly levies a tax on each banking corporation within the State, "[f]or the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity" (Tax Law § 1451[a]). Tax Law § 1455 provides that a banking corporation's franchise tax shall be 9% of its entire net income; and "entire net income" is defined as the "total income from all sources which shall be the same as the entire taxable income *** (1) which the taxpayer is required to report to the United States treasury department" (Tax law § 1453[a]). According to Tax Law § 1453(b)(1)(B), entire net income should be computed without deducting or excluding "any part of any income from dividends or interest on any kind of stock, securities or indebtedness".

New York City likewise imposes a franchise tax on corporations for the privilege of doing business in the City (*see*, Administrative Code of City of NY § 11-602[8][b][2]; *Matter of Bankers Trust N. Y. Corp. v Dept. of Fin.* of *City of N. Y.*, 79 NY2d 457, *cert denied* 506 US 870). The City's franchise tax is measured by a corporation's entire net income, and deductions or exclusions for "any part of any income from *** interest on any kind of stock, securities or indebtedness" are prohibited (Administrative Code § 11-641[b][1][B]).

It is well established that interest paid on State revenue bonds which is exempt from direct taxation is *not* exempt from indirect taxation. Courts have traditionally ruled that such interest *must* be included in the measure of a corporation's total net income for purposes of calculating the corporation's franchise tax obligation, even when the governing statute provides that the income from a municipal bond, for example, "shall at all times be free from taxation, except for estate and gift taxes and taxes on transfers" (*Matter of Anchor Sav. Bank v Chu, supra,* at 889, quoting Private Housing Finance Law § 54; *see also, Werner Mach. Co. v Director of Div. of Taxation, supra; Pacific Co. v Johnson,* 285 US 480; *Forbes v Dept. of Fin. of City of New York,* 66 NY2d 243, cert denied 475 US 1109; *People ex rel. Northern Finance Corp. v Lynch,* 262 NY 477, *affd* 290 US 601). Moreover, as the Supreme Court remarked herein, the plaintiff concedes

that since the enactment in 1933 of the Jones Beach State Parkway Authority Act (L 1933, ch 70, now Title 3, art 2, Public Authorities Law § 150 *et seq.*), the Legislature has not passed a single enabling statute whereby a public authority has been empowered to issue a revenue bond whose interest would be exempt from inclusion in the measure of a corporate holder's income for the purpose of computing its franchise taxes.

IV

Although the challenged legislation is not a tax statute, *any* exemption from taxation "must clearly appear"; and where "a statute or regulation authorizing an exemption is found, it will be 'construed against the taxpayer'" unless the taxpayer can "point to some provision of law plainly giving the exemption" (see, *Matter of Grace v New York State Tax. Comm.*, 37 NY2d 193, 196, quoting *People ex rel. Watchtower Bible & Trust Soc. v Haring*, 8 NY2d 350, 358). In other words, the taxpayer claiming an exemption bears the heavy burden of establishing that clear and unambiguous statutory language creates such an entitlement (*Matter of D. S. Alamo Assocs. v Commissioner of Fin. of City of N. Y.*, 71 NY2d 340, 343; *Matter of Mobil Oil Corp. v Finance Administrator of the City of N.Y.*, 58 NY2d 95, 99). The taxpayer must prove not only that his interpretation of the statute is plausible, but that it is the only reasonable construction (*see*, *Matter of 1605 Book Ctr. v Tax Appeals Tribunal of State of N.Y.*, 83 NY2d 240, 244, *cert denied* ____ US ____, 115 S Ct 61; *Matter of Moran Towing & Transp. Co. v New York State Tax Commn.*, 72 NY2d 166, 172-173; *Matter of Great Lakes Dredge & Dock Co. v Dept. of Taxation & Fin. of State of N.Y.*, 39 NY2d 75, 79, *cert denied* 429 US 832). The plaintiff has failed to show such an unequivocal entitlement here.

As the Supreme Court aptly observed, Public Authorities Law § 1045-u(3), as originally written, was "inartfully drafted" and is in consequence ambiguous in that, among other things, it appears to exempt bondholders from the payment of "real estate" taxes on their bonds and/or the income

therefrom--a situation that could not possibly arise. In addition, by its plain language it exempts bonds and the interest on bonds from "franchise taxes", when, as noted above, only *corporations* are subject to franchise taxes. Finally, although even the plaintiff agrees that such an exemption of interest income from indirect taxation would have been an extraordinary event, and one without precedent in New York's legislative history, the plaintiff would have us believe that the Legislature granted this exemption without so much as a word in the historical record to signal that it was departing from several decades of established practice (*cf*, L 1991, ch 166; Mem of State Executive Dept., McKinney's 1991 Session Laws at 1940-1945).

It is well settled that where the language of a statute is ambiguous, or where a literal construction would lead to absurd or unreasonable consequences that appear contrary to the purpose of the enactment, the courts may resort to other aids, such as the legislative history of the statute, to arrive at its true intended meaning (*see, e.g., Matter of Auerbach v Board of Educ.*, 86 NY2d 198, 204; *see also, Patrolmen's Benevolent Assn. v City of New York*, 41 NY2d 205, 208; *Doctors Council v New York City Employees' Retirement Sys.*, 71 NY2d 669, 674-675; *see also*, McKinney's Cons Laws of NY, Book 1, Statutes, § 76).

There is no indication in the legislative history of Public Authorities Law § 1045-u(3) that the Legislature intended to create an exception to the State and City franchise tax law, or that it contemplated that the interest from such bonds would be excludable from a corporation's entire net income. Rather, the history reflects only an intention to finance local water and sewer districts through revenue bonds as opposed to general obligation bonds (*see*, L 1984, ch 509, 513; Mem of Legislative Representative of the City of New York, McKinney's 1984 Session Laws of NY at 3610-3611, 3330). As noted above, the income from such revenue bonds has traditionally been included in the measure of a corporate bond holder's total net income for franchise tax computation purposes, in New York as well as in other jurisdictions.

Both the language of the 1984 enactment and the surrounding history evince the Legislature's intention that only the Authority would be exempt from franchise taxes (*compare, e.g.,* Public Authorities Law § 1296[8] [L 1967, ch 722, § 1]; Public Authorities Law § 1299-gg [L 1969, ch 1124, § 2]; Public Authorities Law 1316 [L 1970, ch 460, § 2], exempting comparable Public Authorities from franchise taxes). In contrast, the instruments in the hands of the bondholders and the interest earned on them were to be exempt only from *direct* taxes, such as income taxes. Significantly, the bonds were not marketed on the basis of the unusual tax advantage asserted for them by the plaintiff. Accordingly, the plaintiff has failed to carry its heavy burden of proving that, under a proper construction of the 1984 enactment, it was entitled to the exemption claimed (*see, e.g., Matter of D. S. Alamo Assocs. v Commissioner of Fin. of City of N.Y., supra, at 343; Matter of Colt Indus. v New York City Dept. of Fin.*, 66 NY2d 466, 471; *Matter of Mobil Oil Corp. v Finance Administrator of City of N.Y., supra,* at 99).

V

Also weighing in against the plaintiff's construction of Public Authorities Law § 1045-u(3) is the fact that both the State and the municipal franchise tax statutes quoted above expressly *require* that bond interest be included in any calculation of a corporation's entire net income. Accordingly, if the plaintiff's reading of the Public Authorities Law were to be adopted, the provision in question would conflict with State Tax Law § 1453 and Administrative Code § 11-602, *et seq.* However, it is a well-established rule of statutory construction that where an enactment is susceptible of two readings, one of which would cause it to conflict with other laws while the other would not, the latter reading is to be preferred (*see, e.g.,* McKinney's Cons laws of NY, Book 1, Statutes, §§ 98, 141-145, 150, 152, 153, 221-223; *Matter of Burger King v State Tax Comm.*, 51 NY2d 614, 620-621).

Moreover, the plaintiff's interpretation of Public Authorities Law § 1045-u(3) would cause New York State and City

franchise tax enactments to violate Federal law (*see, Memphis Bank & Trust Co. v Garner*, 459 US 392; *Werner Mach. Co. v Director of Div. of Taxation, supra*). 31 USC § 3124(a) provides that " [s]tocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State", *except, inter alia*, for franchise taxes -- provided that such franchise taxes are "nondiscriminatory". For example, a State enactment that purports to exempt the interest from State bonds from a corporation's income for State franchise tax purposes while not according a similar advantage to Federal investments is "discriminatory" and in consequence unconstitutional (*see, Commonwealth v Curtis Pub. Co.*, 69 A2d 410, 363 Pa 299, *cert denied* 339 US 928). The plaintiff's reading of Public Authorities Law § 1045-u(3) would therefore render that enactment discriminatory and unconstitutional, because the interest from New York's Public Authority bonds would be exempted from income used to determine franchise taxes, while the interest from comparable Federal obligations would not receive a similar benefit (*see, Memphis Bank & Trust Co. v Garner, supra; Werner Mach. Co. v Director of Div. of Taxation, supra; Commonwealth v Curtis Pub. Co., supra*). However, it is incumbent upon the courts "to avoid interpreting a statute in a way that would render it unconstitutional if such a construction can be avoided and to uphold the legislation if any uncertainty about its validity exists" (*Alliance of Am. Insurers v Chu*, 77 NY2d 573, 585; *see also*, McKinney's Cons Laws of NY, Book 1, Statutes, § 150[c]).[1]

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[1] It is worthy of note that a further proof that the Legislature did not intend the plaintiff's construction of Public Authorities Law § 1045-u(3) lies in the fact that the enactment fails to provide for a parallel exemption for Federal securities, which it assuredly would have done had it expected such legislation to survive judicial scrutiny (*see, e.g., Commonwealth v Curtis Pub. Co., supra)*. However, it is additionally not reasonable to suppose that the Legislature intended to obtain revenues for the State by exempting *its* bonds from taxation, while in the same piece of legislation eliminating the substantial income the State derives from indirectly taxing comparable Federal securities.

Finally, yet another rule of statutory construction requires that the plaintiff's arguments be rejected. That is, where recourse is had to the Tax Commissioner for his interpretation of a rule involving taxation, the courts should defer to his interpretive expertise, unless his reading of the statute is clearly unreasonable, irrational, or palpably contrary to the Legislature's intention (*see, e.g., Matter of Industrial Indem. Co. v Cooper*, 81 NY2d 50, 54; *Matter of Unimax Corp. v Tax Appeals Tribunal of State of N. Y.*, 79 NY2d 139, 144-145; *Matter of Colt Indus. v New York City Dept. of Fin., supra,* at 471; *Matter of American Tel. & Tel. Co. v State Tax Comm.*, 61 NY2d 393, 400). In its Memorandum of December 18, 1990, the Tax Department ruled emphatically that Public Authorities Law § 1045-u(3) did *not* exempt a corporation's bond interest from its "entire net income" for franchise tax computation purposes. Because this reading is at once eminently rational and maintains the constitutionality of the State and City franchise tax laws, it must be upheld (*see, Matter of Industrial Indem. Co. v Cooper, supra*, at 54; *Matter of Unimax Corp. v Tax Appeals Tribunal of State of N. Y., supra*, at 144-145; *Matter of American Tel. & Tel. Co. v State Tax Comm., supra,* at 400).

VI

Although, in view of the foregoing determination we need not address the plaintiff's remaining contentions regarding the 1991 rewriting of Public Authorities Law § 1045-u(3), we believe it to be worthy of underscoring that the challenged amendment was promulgated to *clarify* the 1984 enactment, and not to change it (*see, e.g., Mayblum v Chu,* 67 NY2d 1008, 1010; *Matter of Eastern Milk Products Coop. Assn. v State of New York Dept. of Agric. & Markets*, 58 NY2d 1097, 1101).

However, assuming, arguendo, that the 1991 legislation changed the 1984 law so as to retroactively eliminate an exemption from taxation, there was no abridgement of the plaintiff's due process rights because the retroactive application was not "harsh and oppressive" (*Welch v Henry,* 305 US

134, *reh denied* 305 US 675; *Canisius College v U.S.*, 799 F2d 18, 25, *cert denied* 481 US 1014). In this context, we note that the plaintiff did not claim its exemption immediately upon purchasing Authority bonds in 1986, but rather waited until 1993 before suing to "recoup" the franchise taxes that it had been paying as a matter of course. There was therefore never any detrimental reliance, justifiable or otherwise, by the plaintiff or anyone else, on the purported "exemption", with the result that it cannot seriously be argued that the retroactive denial of an exemption which nobody claimed is "harsh" or "oppressive" (*see, e.g., Matter of Replan Dev. v Department of Hous. Preservation & Dev. of City of N.Y.*, 70 NY2d 451, 455-456, *appeal dismissed* 485 US 950; *Matter of Neuner v Weyant*, 63 AD2d 290, 300). Moreover, to the extent that the plaintiff professes to have been "disappointed" in its expectation of a tax exemption, we find that such an "expectation" was not "reasonable" under the circumstances (*see, e.g., Matter of Replan Dev. v Department of Hous. Preservation & Dev. of City of Y., supra,* at 456).

Finally, even the passage of six years does not suffice to render retroactive application of the instant amendment "harsh" or "oppressive" (*see, e.g., Matter of Replan Dev. v Department of Hous. Preservation & Dev. of City of N. Y., supra; Matter of Neuner v Weyant, supra, at 302; Matter of Lacidem Realty Corp. v Graves, 288 NY 354; People ex rel. Beck v Graves, 280 NY 405, 409).* Had the plaintiff brought its claim of "entitlement" to the attention of the authorities more promptly--for example, by paying its franchise taxes under protest--the Legislature may have learned of and undertaken to remedy the problem sooner. Parenthetically, the plaintiff's rather lengthy delay in asserting its entitlement to the purported "exemption" also serves to cast doubt upon its threshold argument that the 1984 statute is "clear" and "unambiguous" on its face.

Accordingly the order and judgment is affirmed.

ROSENBLATT, J.P., COPERTINO and ALTMAN, JJ., concur.

ORDERED that the order and judgment is affirmed, with one bill of costs to the respondent and intervenor-respondent appearing separately and filing separate briefs.

ENTER:

Martin H. Brownstein
Clerk

APPENDIX B

SUPREME COURT - STATE OF NEW YORK

Present:

HON. MARVIN E. SEGAL

----------X

ASTORIA FEDERAL SAVINGS & LOAN ASSOCIATION,

Plaintiff(s)

-against-

THE STATE OF NEW YORK and NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE (JAMES J. WETZLER, Attorney General of Commissioner of Taxation and Finance),

Defendant(s).

----------X

TRIAL/IAS, PART 22
NASSAU COUNTY
SHORT FORM ORDER
INDEX NO: 006014/93
MOTION DATE: 7/14/94

PLTF/PET'S ATTORNEY:
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Upon the following papers read on this motion and these cross-motions for an order granting summary judgment;

Notice of Motion/Order to Show Cause .....X ;
Affidavit in Support.....X ;
Notice of Cross Motion and supporting papers .....X ;
Notice of Cross Motion.....X ;
Memorandum of Law (3).....X ;
Replying Memorandum of Law (3).....X ;it is

ORDERED, that these motions are decided as follows:

In 1984 the New York State Legislature enacted Title 8-A of Article 5 of the Public Authorities Law (PAL) entitled the "New York State and Local Water and Sewer Authority Act", (hereinafter referred to as the "Act"), for the purpose of providing safe, adequate water supplies and sewer services to the people of this State. In the same year the legislature created and organized twelve local water and sewer public authorities. These local public authorities, all of which are separate legal entities, are statutorily empowered to issue debt obligations in order to finance the renovation and improvement of the local water and sewer systems served by each authority.

The plaintiff, a federal savings and loan association, purchased certain Water and Sewer revenue bonds (hereinafter referred to as the "Bonds"), series A, fiscal 1986, issued by the New York City Municipal Water Finance Authority (hereinafter referred to as the "Authority"), a local water and sewer public authority created in 1984 pursuant to PAL 1045-a. (The "Bonds" purchased by the plaintiff mature on June 15, 2015, and accrue interest at an annual rate of nine and one quarter percent).

At the time the "Bonds" were issued, PAL Section 1045-u.3 provided as follows regarding bonds issued by the "Authority":

> Any bonds issued pursuant to this title (2-A of Chapter 5) together with the income therefrom as well as the revenues, moneys and all other property and activities of the authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the State or any municipality including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. The state hereby covenants with purchasers and all subsequent holders and transferees of bonds issued by the authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the

> income therefrom and all revenues, moneys, and other property pledged to secure the payment of such shall be at all times free from such taxes, except for transfer and estate taxes.

(Similar language appears in the enabling legislation, PAL 1196-1.3 of Title 8-A, and in various other sections of the PAL, creating uniformity as to all revenue bonds issued by the twelve local water and sewer public authorities).

The plaintiff contends that the aforesaid statute provides, in clear and unequivocal language, that the income generated by the "Bonds" is exempt from the measure of plaintiff's income for purposes of calculating plaintiff's state and city franchise tax obligations. Further, the plaintiff alleges that it purchased the "Bonds" specifically because the income interest generated by the "Bonds" was exempt from inclusion in the computation of the plaintiff's net income for the purpose of determining plaintiff's franchise taxes under Articles 9-A and 32 of the New York Tax Law and Chapter 6, Title 11, of the New York City Administrative Code.

Subsequent to its purchase of the "Bonds", the plaintiff filed a claim with the New York State Department of Taxation and Finance (hereinafter referred to as the "Tax Department"), seeking a refund of franchise taxes plaintiff paid, for the period December 31, 1985 through December 31, 1988, on the income from interest earned on tax exempt federal bonds, on the ground that 31 U.S.C. 3124(a) prohibits discriminatory treatment, by the State, as to interest paid on federal obligations. 31 U.S.C. 3124(a) provides that interest income from tax exempt federal obligations may be included in the measure of state franchise taxes only if the franchise tax is non-discriminatory. Plaintiff contends that it is impermissibly discriminatory to exempt interest income from the State "Bonds", and not to exempt interest income from federal bonds in determining plaintiff's net income for purposes of calculating plaintiff's State and City franchise tax obligations. (*see*, *Memphis Bank & Trust v. Garner*, 459 U.S. 392).

On or about December 18, 1990, the "Tax Department" through its Taxpayer Services Division Technical Services Bureau issued Memorandum TSB-M-90(14)C addressing the question of whether bonds or the interest thereon issued by New York State authorities, such as the "Authority" herein, were exempt from New York State corporate franchise taxes. Said Memorandum concluded that the exemption from franchise taxation applied only to the activities of an authority and not to the bonds or the interest from the bonds issued by an authority, and that the interest from said bonds must be included in net income pursuant to Tax Law 1453(b)(1).

Subsequently, on or about June 3, 1991, the State legislature enacted L. 1991, ch. 166, Sections 22-37, as part of a series of amendments to Article 5 of the PAL pertaining to the tax treatment of interest on bonds issued by local public authorities. PAL 1045-u.3 as amended provides:

> Any bonds issued pursuant to this title together with the income therefrom [as well as] *shall be exempt from taxation except for transfer and estate taxes. The* revenues, money and all other property and activities of an authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the state or any municipality including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes--[except for transfer and estate taxes] ...The state hereby covenants with the purchasers and all subsequent holders and transferees of bonds issued by an authority pursuant to this title, ... that the bonds of the authority issued pursuant to this title and the income therefrom *shall be free from such taxation, as aforestated herein*, and *that* all revenues, moneys, and other property pledged to secure the payment of such shall at all times be free from such taxes, [except for transfer and estate taxes] as *aforestated herein.*

(Material deleted from the original version of 1045-u.3 has been placed in brackets; underscored material denotes matter

added by the amendment). All such amendments to the various sections of the PAL, including section 1045-u.3 were declared by the State legislature to be effective retroactive to July 24, 1984, the original effective date of the "Act".

On or about August 25, 1991, the Commissioner of Taxation and Finance disallowed the plaintiff's claim for a franchise tax refund on the grounds that: 1) Article 32 Section 1453(a) of the New York State Tax Law does not exclude interest from federal obligations in the determination of net income and 2) the interest income from federal obligations is taxable for New York State franchise tax purposes because 31 U.S.C. 3124 permits the inclusion of interest paid on federal obligations in the measure of state franchise taxes where the state franchise tax is nondiscriminatory, and the New York State franchise tax is nondiscriminatory.

On or about October 26, 1992, the plaintiff filed a petition with the "Tax Department", pursuant to Article 27 of the Tax Law seeking a refund of the aforesaid franchise taxes. Said petition recites that:

> (The) commissioner improperly disallowed petitioner's claim for refund. Notice of Disallowance, dated August 25, 1991, attached. The New York State Franchise Tax on Banking Corporations (Article 32 of the Tax Law) imposes a tax that impermissibly discriminates against obligations of the United States Government and the interest on such obligations in violation of 31 U.S.C. Section 3124(a). Therefore, petitioner claims refund based on the recalculation of its tax after excluding said obligations and the interest thereon from the measure of the tax.

Said petition is now awaiting an administrative hearing before the "Tax Department".

On or about March 3, 1993 the plaintiff commenced the instant declaratory judgment action seeking a judgment 1) declaring that PAL 1045-u.3, as originally enacted exempts

interest on the "Bonds" issued by the "Authority" from inclusion in the measure of plaintiff's franchise tax and 2) declaring the 1991 amendments to the PAL (L.1991, ch 166, Sections 22-37) to be unconstitutional, retroactively and prospectively.

The plaintiff now moves for summary judgment against all the defendants for the relief sought in the complaint, on the ground that there are no disputed factual issues and the matters before the court involve pure questions of statutory construction. The plaintiff contends that the plain language of PAL 1045-U.3, as originally enacted, precisely and unambiguously, exempts the "Bonds" and the interest paid on the bonds from franchise taxes and that the statute must be applied as written, without resort to rules of construction or extrinsic aids. Plaintiff further contends that the interpretation of the statute by the "Tax Department" is contrary to, and inconsistent with the plain language of the statute, and that said interpretation therefore lacks legal effect and should be disregarded. As for the amendment enacted in 1991, the plaintiff asserts that the amendment frustrated rather than clarified the legislative intent underlying the promulgation of the 1984 statute, and that the amendment impermissibly impaired plaintiff's contract with the State of New York in violation of the State and Federal constitutions. Finally, plaintiff contends that the retroactivity provisions of the 1991 amendment are excessive and constitute an unconstitutional denial of due process.

The defendants, the State of New York and the New York State Department of Taxation, cross move for summary judgment for an order declaring that PAL 1045-u.3, as originally enacted in 1984, did not exempt the interest from the "Bonds" from inclusion in the calculation of franchise taxes, but rather exempted the "Authority" from the any franchise tax obligation. Said defendants contend that such construction of the Statute is the only construction which renders the statute meaningful, is consistent with the legislative intent and harmonizes the Statute with applicable tax statutes. In the alternative, said defendants contend that even if the court does

not so construe the statute as enacted in 1984, the defendants are entitled to summary judgment declaring that the 1991 amendment constitutes a constitutionally permissible retroactive tax; that the retroactive application is neither harsh or oppressive, as the plaintiff has failed, as a matter of law, to demonstrate justifiable reliance on the language in the "Bonds" relating to franchise taxes. Finally, said defendants contend that the 1991 amendment did not deprive the plaintiff of due process of law.

The defendant-intervenor, The City of New York, also cross moves for summary judgment declaring that the interest from the "Bonds" is not exempt from inclusion in the measure of the City's franchise taxes, and that the "Bonds" are non-discriminatory pursuant to 31 U.S.C. Section 3124(a). The City contends that inartful draftsmanship of the 1984 statute created an ambiguity which was clarified by the statutory construction, consistent with legislative intent, issued by the "Tax Department", and that this rational construction must be confirmed by the court. The City argues, in the alternative, that even if no ambiguity exists, the literal or plain meaning of a statute must yield to avoid absurd, harmful or unreasonable results, and to avoid public mischief or injustice, and that the court must look to the purpose of the legislation as a whole rather than its literal words. The City further contends that even if the court does not confirm the "Tax Department's" construction of the 1984 statute, the 1991 amendment is constitutional, prospectively and retroactively, as the application of the amendment is not harsh or oppressive.

Franchise taxes are excise taxes imposed on corporate entities for the right and privilege of carrying on a business as a corporation (71 Am.Jur.2d *State and Local Taxation* Section 266 [1973]; 24 N.Y.Jur., *Franchises* Section 1 [1962]). A franchise tax is not a direct tax on income. Rather, a corporation's income or its capital forms the basis for the measurement of the entity's franchise tax obligation. (*Werner Machine Co. v. Director of Taxation*, 350 U.S. 492; *Educational Films Corn. v. Ward*, 282 U.S. 379, 386-392; *Bass, Ratcliff & Gretton Ltd. v. State Tax Comm'n*, 266 U.S. 271,

affirming 232 NY 42; *Dreyfus Special Income Fund, Inc. v. New York State Tax Comm'n*, 126 AD2d 368, affirmed 72 NY2d 874; *Flint v. Stone Tracy Co.*, 220 U.S. 107, 165). Article 9-A of the State Tax Law expressly imposes a state franchise tax on corporations, and Article 32-A of the State Tax Law expressly imposes a tax on a Banking corporation "for the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity" (Tax Law Sections 209, 1451). New York City also imposes a franchise tax pursuant to the Banking Corporation Tax and the General Corporation Tax (Admin.Code Sections 11-602[b][2]; 11-641[b][1][B]; *see*, *Bankers Trust Corp. v. Department of Finance*, 79 NY2d 457, cert. den., ____ U.S. ____, 13 S.Ct. 202).

Generally, the interest paid on state revenue bonds which is exempt from direct taxation, such as income taxes, is not exempt from indirect taxation, and such interest must be included in the measure of a corporation's total net income for purposes of calculating the corporation's franchise tax obligation (*Werner Machine Co. v. Director of Taxation*, supra; *Anchor Savings Bank v. Chu*, 117 AD2d 889). The law is clear that even where a statute provides that the income from a municipal bond will be "at all times free from taxation, except for estate and gift taxes and taxes on transfers", the income is subject to the indirect taxation of a franchise tax (*see*, *Werner Machine Co. v. Director of Taxation*, supra; *Pacific Co. Ltd. v. Johnson*, 285 U.S. 480; *People ex rel. Northern Finance Corp. v. Lynch*, 290 U.S. 601, affirming 262 NY 477; *Forbes v. Department of Finance of the City of New York*, 66 NY2d 243; *Anchor Savings Bank v. Chu*, supra).

Since 1933 (Jones Beach State Parkway Authority Act. L. 1933, ch. 70, now Title 3, Article 2, Public Authorities Law, Sections 150 *et seq.*), New York State public benefit corporations have issued tax exempt bonds in order to finance the construction of public improvement projects. None of the enabling statutes promulgated between 1933 and 1984 contained any language exempting the income generated by tax exempt bonds issued by a public authority, from inclusion in

the measure of a corporate bondholder's net income for purposes of determining the corporation's franchise tax liability. Rather, the various statutes enacted during this period regarding bonds issued by a public authority, uniformly provided that the bonds and income "shall at all times be free from taxation, except for transfer and estate taxes". During the 1984 legislative session, in addition to the "Act", the legislature enacted General Municipal Law Section 960, the Municipal Development Law, which created a municipal authority empowered to issue bonds "exempt from taxation for municipal and state purposes, except for transfer and estate taxes." (L.1984, ch. 916, section 3). Plaintiff argues that the reference to franchise taxes set forth at length hereinabove, in PAL 1196-1.3 and PAL 1045-U.3, as enacted in 1984, in clear, unequivocal and unambiguous terms, demonstrates an intentional departure by the legislature from the aforesaid 50 year precedent, and that the statute in clear and unambiguous terms, exempts the "Bonds" and the income generated by the "Bonds"from the indirect taxation imposed by the State's and the City's franchise taxes. Plaintiff contends that the court is obligated to so construe the statutes according to their clear, unequivocal and unambiguous terms.

All parties herein agree that from 1933 until 1984 not a single enabling statute was enacted which empowered a public authority to issue a revenue bond which provided that the bond or the interest paid thereon would be exempt from inclusion in the measure of a corporation's franchise tax. While plaintiff contends that PAL 1196-1.3 (PAL 1045-U.3 and the other statutes relating to the eleven other State Water and Sewer Districts) is a unique departure by the New York State legislature from this 50 year precedent, the defendants contend that the plaintiff has failed to demonstrate that the legislature intended, by the language utilized in the subject statutes, to create "a shift in the face of 50 years of established jurisprudence."

The defendants contend that the language of the Statute is unclear and ambiguous due to "inartful draftsmanship"; that the reference to franchise taxes in the subject statutes refers

only to the "Authority" and not to the "Bonds" or the income paid by the "Bonds"; that the statutes generally exempt the "Bonds", the income therefrom and the properties and activities of the "Authority" from all taxes imposed by the State or any municipality, and then simply lists categories of various types of taxes (including, but not limited, to real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes), some of which are applicable to the "Bonds" and the income thereon, and others, including real estate taxes and franchise taxes, which can only be applicable to the property and activities of the "Authority." The defendants contend that, the reference to real estate taxes relates only to the "Authority," as a bondholder could never be called upon to pay real estate taxes on the "Bonds" or the interest generated by the "Bonds." Similarly, the defendants contend that the reference to franchise taxes relates only to the "Authority" since neither the "Bonds" nor the income therefrom is subject to a franchise tax, but rather it is an entity, such as the "Authority" which would be subject to a franchise tax if not granted an exemption from such taxation. In support of this contention, the defendants note that various statutes enacted prior and subsequent to 1984, explicitly exempt public authorities from franchise taxes. (*see, e.g., Environmental Facilities Corporation* PAL §1296[8] (L. 1967, ch 722 §1); *Rochester-Genessee Regional Transportation Authority*, PAL 1299-gg [L. 1969, ch.1124 §2]; Capital District Transportation Authority, PAL §1316 [L.1970, ch.460 §2]; Central New York Regional Transportation Authority, PAL §1341 [1.1970, cm. 714 §2]; Niagara Frontier Transportation Authority, PAL §1299-o [L. 1967, ch. 717 §96]; Transit Construction Fund Authority, PAL §1266-m [L.1990, ch. 730 §1]; Metropolitan Transportation Authority, PAL §1275; Savings and Loan Insurance Fund, Banking Law 420-e). The defendants further recite several Statutes relating to the tax exempt status of public authorities and the bonds issued by said authorities which, in similar "inartful language", in a single sentence, make reference to the tax exempt status, of both an authority and the bonds and the income paid by the bonds, without

specifying the categories of taxes from which each is exempt (*see e.q.*, PAL Sections 585, 1082).

The defendants contend that the subject statutes are unclear and ambiguous; that the plaintiff has failed to show that its interpretation of the statutes is the only rational interpretation; and that the construction given by the "Tax Department" and the legislature by virtue of the 1991 amendment is rational and must be confirmed by the court. The defendants contend that plaintiff relies on nothing other than the "inartful draftsmanship" of the statutory language as evidence of a legislative intent to afford the "Bonds" and the income therefrom a unique exemption from inclusion in the measure of a corporate bondholder's franchise taxes. The defendants point out that the legislative history, as set forth in the 1984 Governor's Memorandum, New York State Legislative Annual, and Memorandum of Legislative Representative of City of New (1984 McKinney's Session Laws at pp. 3610-3611, 3330), indicates no legislative intent other than to allow revenue-backed financing rather than funding through general obligation bonds. Further, it is uncontroverted that the "Bonds" were never marketed on the basis that the "Bonds" and the income from the "Bonds" were exempt from inclusion in the measure of a corporate bondholder's franchise taxes. No mention of any such tax advantage appears in the official statement which should have contained all information pertinent to prospective investors. In fact, the cover page of the official statement of the prospectus provided only that "(i)n the opinion of Bond Counsel, under existing law interest on the Bond is exempt from federal income taxes and from personal taxes levied by New York State or any political subdivision thereof, including the City of New York." Similar language appears in the body of the official statement. Further, Bond Counsel's Opinion letter accompanying the "Bond"s, which addresses the legality of the "Bonds", and their tax exempt status states only that the "Bonds" are exempt from Federal income taxes and personal taxes levied by the State and City.

A taxpayer seeking an exemption or to exclude a particular item from taxation bears the burden of establishing the clear and unequivocal entitlement to such exemption (*Moran Towing and Transportation Co. v. N.Y.S. Tax Commission*, 72 NY2d 166, 172-173; *Mobil Oil Corp. v. Finance Administrator*, 58 NY2d 95, 99; *Grace v. New York State Tax Commission*, 37 NY2d 193, 196-197; *People ex rel. Mizpah Lodge v. Burke*, 228 NY 245; *Garfield Trust Co. v. Director, Division of Taxation*, 102 NJ 420, *appeal dismissed*, 479 U.S. 925).

Moreover, a court may not depart from an administrative construction of a statute which has a rational basis in the law and is not clearly erroneous or unauthorized (*see e.g., Industrial Indemnity Co. v. Cooper*, 81 NY2d 50; *American Telephone & Telegraph Co. v. State Tax Commission*, 61 NY2d 393, 400; *Matter of Young v. Bragalini*, 3 NY2d 602, 605). While the interpretation of a Statute urged by a taxpayer, affording an exemption, may be reasonable, the taxpayer will not prevail, where the construction adopted by the administrative agency, denying the exemption, is also reasonable (*see, Weil v. Retirement Plan Administrative Committee*, 933 F.2d 106; *Matter of Bamberger Polymers Inc. v. Chu*, 111 AD2d 589, *lv. den.*, 66 NY2d 603; *see also, Unimax Corp. v. Tax Appeals Tribunal*, 79 NY2d 139, 144-145, quoting matter of *Long Island Lighting Co. v. State Tax Commission*, 45 NY2d 529).

Here, the court finds that the plaintiff has failed to establish, "by language so clear as to admit no argument" (*People ex rel. Mizpah Lodge v. Burke*, supra at 247) that it is entitled to exempt the "Bonds" and the income therefrom from inclusion in the measure of plaintiff's net income for purposes of the calculation of plaintiff's State and City franchise tax obligations. The relevant legislation, PAL 1196-1.3 and 1045-U.3, as enacted in 1984, is unclear and ambiguous as a result of inartful draftsmanship. The statutory language exempts the "Bonds" and the income therefrom, and the property and activities of the "Authority" from all taxes, and then lists, without limitation, various types of taxes. It is unquestionable that the reference to real estate taxes is not relevant to

the "Bonds" or the income therefrom. Analogously, under a rational interpretation of the statutes, the reference to franchise taxes has no relevance to the "Bonds" or the income therefrom, but relates only to the "Authority."

Pursuant to the precedent cited above, it is well settled that a court must defer to and confirm an administrative agency's rational construction of a statute relating to a tax exemption. Here, the "Tax Department's" interpretation of the relevant legislation, as set forth in its memorandum TSB-M-90(14)C is rational and as such must be confirmed by the court (*see, Weil v. Retirement Plan Administrative Committee*, supra). Said construction harmonizes the subject statutes with Articles 9-A and 32 of the Tax Law and Chapter 6, Title 11 of the New York City Administrative Code (*see, e.g., Heard v. Cuomo*, 80 NY2d 684; *Burger King Inc. v. State Tax Commission*, 51 NY2d 614; *Garfield Trust Company v. Director, Division of Taxation*, supra; *American Motor Sales Corp. v. Brown*, 152 AD2d 343, or reconciles them through the principle of *in pari materia* (*see,e.g., Matter of Estate of Seaman*, 78 NY2d 452, 458; *see generally*, McKinney's Statutes Section 221[b]).

Finally, the construction adopted by the "Tax Department" is in accord with the legislative intent which is the key to statutory construction (*see e.g. People ex rel. Wood v. Lacombe*, 99 NY 43, 49; *Matter of Asthman v. Kelly*, 2 NY 567, 572; *Essenfeld Bros. v. Hostetter*, 14 NY2d 47, 52; *Matter of Petterson v., Daystrom Corp.*, 17 NY2d 32, 38-39; *Matter of Long v. Adirondack Park*, 76 NY2d 416, 422). Despite plaintiff's supposition that PAL 1196-1.3 was enacted in specific response to *Anchor Savings Bank v. Chu*, supra, the plaintiff has not offered a scintilla of evidence in support of its position as to legislative intent. Rather, the Governor's Memorandum, the City's Memorandum, the Official Statement and Bond Counsel's Opinion Letter accompanying the Prospectus evince only a legislative intent to finance the water and sewer districts through revenue bonds as opposed to general obligation bonds. Further, said documents demonstrate a legislative intent only to exempt the "Bonds" from federal, state and

local income taxes. No proof whatsoever has been adduced of any legislative intent to depart from 50 years of precedent which included the income paid by revenue bonds issued by a State public authority in the measure of a corporate bondholder's total net income for purposes of calculating the corporation's franchise tax obligation.

The construction of PAL 1196-1.3 and PAL 1045-u.3 adopted by the "Tax Department" is rational and in accord with the legislative intent underlying the promulgation of the 1984 legislation.

Accordingly, the motion by plaintiff is denied and the cross motions of the defendants are granted. The defendants are granted summary judgment declaring that PAL 1045-u.3 as originally enacted in 1984 did not exempt the "Bonds" or the income therefrom from inclusion in a corporate bondholder's capital or total net income for purposes of calculating the corporation's State and City franchise tax obligations.

DATED: 8/29/94

_____

J.S.C.

APPENDIX C

State of New York,
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the twenty-second day of October 1996

Present, HON. JUDITH S. KAYE, Chief Judge, presiding.

Mo. No. 1394 SSD 96

In the Matter of Astoria Federal Savings & Loan Association,

Appellant,

vs.

State of New York, et al.,

Respondents,

City of New York,

Intervenor-Respondent.

The appellant having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte*, upon the ground that no substantial constitutional question is directly involved.

/s/Stuart M. Cohen
Stuart M. Cohen
Deputy Clerk of the Court

APPENDIX D

State of New York,
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the sixth day of February 1997

Present, HON. JUDITH S. KAYE, Chief Judge, presiding.

2-10 Mo. No. 1648

In the Matter of Astoria Federal Savings & Loan Association,

Appellant,

vs.

State of New York, et al.,

Respondents,

City of New York,

Intervenor-Respondent.

A motion for leave to appeal to the Court of Appeals in the above cause having been heretofore made upon the part of the appellant herein and papers having been submitted thereon and due deliberation thereupon had, it is

ORDERED, that the said motion be and the same hereby is denied.

/s/Stuart M. Cohen
Stuart M. Cohen
Clerk of the Court

APPENDIX E

New York Public Authorities Law
Article 5, Title 2-A
New York City Municipal Water Finance Authority

Section 1045-t. Agreement with State

The state does hereby pledge to and agree with the holders of any bonds issued by the authority pursuant to this title that the state will not alter or limit the rights hereby vested in the authority or the water board to fulfill the terms of any agreement made with or for the benefit of the holders of bonds, or in any way impair the rights and remedies of bondholders, until the bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of such holders, are fully met and discharged. The authority is authorized to include this pledge and agreement of the state in any agreement with bondholders.

Section 1045-u. Exemptions from taxes, assessments and certain fees; payments in lieu of taxes (as enacted in 1984):

1. It is hereby determined that the creation of the authority and the carrying out of its corporate purposes is in all respects for the benefit of the people of the city and of the state and is a public purpose and the authority shall be regarded as performing a governmental function in the exercise of the powers conferred upon it by this title and shall not be required to pay any taxes, special ad valorem levies or special assessments upon any real property owned by it or any filing, recording or transfer fees or taxes in relation to instruments filed, recorded or transferred by it or on its behalf. The authority shall be

deemed a public authority for the purposes of section four hundred twelve of the real property tax law.

* *

3. Any bonds issued pursuant to this title together with the income therefrom as well as the revenues, moneys and all other property and activities of an authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. The state hereby covenants with the purchasers and all subsequent holders and transferees of bonds issued by an authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom and all revenues, moneys, and other property pledged to secure the payment of such shall at all times be free from such taxes, except for transfer and estate taxes.

* *

Section 1045-u Exemptions from taxes, assessments and certain fees; payments in lieu of taxes (as amended in 1991)

* *

3. Any bonds issued pursuant to this title together with the income therefrom [~~as well as the~~] shall be exempt from taxation except for transfer and estate taxes. The revenues, moneys and all other property and activities of an authority shall be exempt from all taxes and governmental fees and charges, whether imposed by the state or any municipality including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes [~~except~~

~~for transfer and estate taxes~~]. The state hereby covenants with the purchasers and all subsequent holders and transferees of bonds issued by an authority pursuant to this title, in consideration of the acceptance of and payment for the bonds, that the bonds of the authority issued pursuant to this title and the income therefrom shall be free from such taxation, as aforestated herein, and that all revenues, moneys, and other property pledged to secure the payment of such shall at all times be free from such taxes, [~~except for transfer and estate taxes~~] as aforestated herein.*

Section 1045-bb. Effect of inconsistent provisions

Insofar as the provisions of this title are inconsistent with the provisions of any other law, general, special or local or of the city charter or any local law, ordinance or resolution of the city, the provisions of this title shall be controlling, provided that nothing contained in this section shall be held to supplement or otherwise expand the powers or duties of the authority otherwise set forth in this title. Nothing contained in this title shall be held to alter or abridge the powers and duties of the state department of environmental conservation or the state department of health.

***Deleted material placed within brackets and printed with strikeouts [~~deleted~~]; underscored material denotes matter added by the amendment.**

APPENDIX F

Memorandum of Department of Taxation and Finance

Technical Services Bureau Memorandum TSB-M-90(14)C issued December 18, 1990 (footnote in original):

A question has arisen as to whether bonds of particular New York State public authorities or the interest on such bonds is exempt from New York State corporate franchise taxation.

Title 8-A of Article 5 of the Public Authorities Law, "The New York State Local Water and Sewer Authority Act" (the Act), authorizes the creation of local water and sewer authorities.

Subdivision 3 of such section 1196-l provides in relevant part as follows:

> 3. Any bonds issued pursuant to this title together with the income therefrom as well as the revenues, moneys and all other property and activities of an authority shall be exempt from all taxes and governmental fees or charges, whether imposed by the state or any municipality, including without limitation real estate taxes, franchise taxes, sales taxes or other excise taxes, except for transfer and estate taxes. ...[1]

---

[1]The same language is found in the specific enabling acts relating to the following local authorities created by the following sections of the Public Authorities Law: Green Island Power Authority, § 1020-m; New York City Municipal Water Finance Authority, § 1045-u; Buffalo Municipal Water Finance Authority, § 1048-u; Albany Municipal Water Finance Authority, § 1115-t; Town of Clifton Park Water Authority, § 1120-n; Water Authority of Great Neck North, § 1197-m; Water Authority of Western Nassau County, § 1198-n; Rensselaer County Water and Sewer Authority, § 1199-n; Wayne County Water Authority, § 1199-nn; Orange County Water Authority, § 1199-oo; Saratoga County Water Authority, § 1199-nnn: Greater Utica County Water Finance Authority, § 1226-m.

Technical Services Bureau Memorandum TSB-M-90(14)C issued December 18, 1990 (footnote in original) (Continued):

The question as to whether the bonds or the interest on the bonds issued under the Act is exempt from the corporate franchise taxes stems from the enumeration of "franchise taxes" in the examples that follow the statutory language which lays down the general tax exemption rule. We have concluded that the term

"franchise taxes" refers to and modifies the exemption from taxation of activities of the Authority but not the bonds or the interest from the bonds of the Authority. Therefore, the bonds and the interest on the bonds is to be treated as follows.

Article 9

The interest income on the public authority bonds is included in gross earnings for purposes of the taxes imposed by sections 184, 184-a, 186 and 186-b of the Tax Law.

Article 9-A

The interest income on such bonds is included in entire net income pursuant to Tax law, § 208.9(b)(2). The bonds are included in business capital as defined in Tax Law, § 208.7 or investment capital as defined in Tax Law, § 208.5, as the case may be.

Article 32

The interest income on such bonds is included in entire net income pursuant to Tax Law, § 1453(b)(1). This memorandum makes no determination as to whether the interest income on such bonds qualifies for the deduction in determining entire net income set forth in Tax Law, § 1453(e)(12). Such bonds are included in the computation of taxable assets pursuant to Tax Law, § 1455(b)(1).

Article 33

The interest income on such bonds is included in entire net income pursuant to Tax Law, § 1503(b)(2)(B) and the bonds are business capital as defined in Tax Law, § 1500(j) or investment capital as defined in Tax Law, § 1500(i), as the case may be.

APPENDIX G

Preamble to Section § 22, Chapter 166 Laws of 1991:

> *Legislative Intent.* The purpose of sections twenty-two through thirty-six of this act is to make it unquestionably clear and reaffirm that, in accordance with general, longstanding state policy relating to obligations of the state and its agencies, entities, authorities and political subdivisions, the obligations of the specific authorities enumerated in this act which have been created under the public authorities law and the interest on such obligations have always been subject to indirect taxation, including state and local franchise, estate, gift and transfer taxation. Federal law generally prohibits more favorable treatment for state or local tax purposes of state or local obligations or state-created entity obligations than that accorded federal obligations. Therefore, the legislature (1) declares that the intention of the legislature in enacting the statutes empowering the herein enumerated authorities to issue certain obligations and mentioning in such statutes the exemption from franchise taxes was solely that the operation of such authorities so enumerated would be exempt from franchise taxes, in contrast to any exemption or exclusion from any franchise taxes with respect to entities which might hold such obligations; (2) declares that it has never been a legislative intent to enact a tax exemption for obligations of such authorities so enumerated which would render any state or local indirect tax on interest income therefrom discriminatory with respect to federal obligations; and (3) finds that the obligations of such authorities so enumerated were not sold on any official representation to purchasers that interest income deriving from such obligations would not be included in the measure of franchise taxes on such holders. In any event, the aforementioned sections, including the effective date thereof,

makes it clear and reaffirms that the tax exemption with respect to such obligations of such authorities so enumerated and the interest income thereon, from inception, related solely to direct taxation.